



TO: North County Library Authority (NCLA) Commission

FROM: Marcie Scott, Liaison

DATE: March 22, 2021

SUBJECT: NCLA Financial Status Update

RECOMMENDATION: Receive update and accept the report from Mr. Morreale; Direct the Ad Hoc Committee to finalize the full transfer of NCLA funds remaining with the City of Los Altos through 2/28/21 plus the recalculated amount of interest due.

Background

On November 16, 2020 the NCLA Commission approved obtaining technical assistance to determine if NCLA funds invested with City of Los Altos earned income that is due to NCLA and to assist in finalizing the transfer of remaining funds from the City to the County. Mr. Russ Morreale, a past Director of Finance & Technology for the City of Los Altos, has generously agreed to assist NCLA pro bono. Working with an Ad Hoc Committee of Secretary Epstein and Liaison Scott, City data has been collected and reviewed, discussions have occurred with Interim City Manager and Deputy City Manager, and information requested from PFM has been provided.

On December 2, 2020, NCLA sent reimbursement requests to the two Member Entities to reimburse NCLA for legal, audit and Liaison costs pursuant to the Joint Powers Agreement. Both payments have been received in NCLA's account at the County.

Pending Issues

Mr. Morreale has reviewed a substantial number of data reports, statements and investment quarterly reports. This information informed Mr. Morreale's recalculation of interest earned by NCLA funds invested with the City of Los Altos brokerage fund. Attachment 3b details his methodology, analysis and recommendations. The findings indicate \$58,977 in interest income was earned by the NCLA investment with Los Altos that has not been transmitted to NCLA.

NCLA funds remain in a cash account and the NCLA LAIF account at the City of Los Altos. It is recommended those funds as of February 28, 2021 be transferred to NCLA's account at Santa Clara County.

Recommendation

It is recommended the NCLA Commission accept the report from Mr. Morreale and direct the Ad Hoc Committee to finalize the full transfer of NCLA funds remaining with the City of Los Altos through February 28, 2021 plus the recalculated amount of interest due.

Attachment:

- 3b - Report to NCLA Commission from Mr. Russ Morreale dated 3/22/21 with exhibits

FROM THE DESK OF

Russell J. Morreale

Date: March 22, 2021

To: North County Library Authority Board (NCLA) Members
From: Russell J. Morreale

Re: NCLA Fiscal Project Findings & Resolution

Attachment(s):

Exhibit A - Monthly Calculation of NCLA Interest Earned in PFM Commingled Account
Exhibit B - Accounting of City Booked NCLA Interest from FY 16-17 to October 2019

Executive Summary

The analysis included herein concludes that the recalculated interest amount from the City's commingled investment account (PFM) earned by NCLA from October 2016 through October 2109 equaled \$186,340 in contrast to the amount recorded by the City of \$127,363 resulting in an interest income shortfall, and amount due from the City, of **\$58,977**. Furthermore, NCLA cash holdings held by the City at June 30, 2020 equal **\$777,462.06**, an amount subject to transfer to the County along with minor expected adjustments through February 28, 2021.

Background

This report follows up on the January 25, 2021 NCLA public meeting discussion of existing fiscal queries. Since that time the informational requests made by NCLA to the City have been acted upon resulting in the analysis included herein. This analysis focused on three objectives: (1) quantifying the amount of interest that was, and should have been, allocated to NCLA by the City since October 2016, when funds were deposited into a City managed commingled investment account, (2) realizing the full transfer of NCLA cash held by the City to the Santa Clara County Pool [SCC], including interest due, and (3) solidifying the fiscal reporting process with SCC. With the cooperation of the City, this report presents key findings, conclusions and resolving recommendations.

City Discussions & Other Communications

On February 1, 2021, Marcie Scott and I contacted the City's Interim City Manager Brad Kilger and Deputy City Manager Jon Maginot. We discussed the project purpose and open documentation requests. We found the City to be quite willing to help NCLA

complete its final fund transfer while continuing to maintain the existing supportive relationships (agenda postings, web presence) in place. They also seemed open to continued joint audit coordination. Their helpful posture is key to resolving the matter at hand.

Subsequently, the City acted on NCLA's long standing data requests and additional follow up items, listed below:

- Access to Commingled Investment Account (PFM) Monthly/Quarterly statements
- Access to California State Pool (LAIF) statements
- Updated NCLA Trial Balances through June 30, 2020
- Correspondence from the City authorizing contact with PFM

As of the date of this report, NCLA's June 30, 2020 final audit is not yet available and we await the unaudited NCLA Trial balance through February 28, 2021. Once received, the analysis will be rounded up through the latest month of cutoff, February 2021.

We also reached out to two other agencies in obtaining clarifying information. These included communications with the Santa Clara Pool and PFM.

PFM Interest Allocation Calculations

Attached is ***Exhibit A - NCLA PFM interest allocation - monthly*** illustrating the core findings of my NCLA interest income analysis. It is further supported by ***Exhibits B***.

I approached this project by going straight to the source in performing an independent recalculation of interest income that should have accrued to NCLA. This was compared to the NCLA interest income the City recorded to identify the shortfall amount to arrive at a supportable and clear finding as we approach the City for payment. The parameters and conclusions of this analysis follow:

- Key data sources include City provided PFM actual month/QTR end statements.
- The interest recalculation spanned 37 months from Oct. 2016 through Oct. 2019.
- Recalculated interest was based on the total of PFM holdings, not all City fund holdings, correcting the key error in the City's accounting model.

- Recalculated interest was performed monthly, as opposed to the City's quarterly recording, to present a more timely model, target actual cash basis interest reported by PFM at month end, and provide an easily reconcilable trail.
- Recalculated monthly interest was added to NCLA's initial principal balance (\$3.12M) to compound the impact of the earnings over the project term, something the City did not do.
- The calculation considered Actual Interest/Dividends/Coupon (cash basis) income received per the PFM statements and not actual gains/losses/accrued interest purchased, consistent with the City's calculation base.

Since the initial Oct 2016 deposit of NCLA funds into PFM, the City has not withdrawn NCLA principal, or interest, from the PFM account. In fact, it appears the distribution of original principal to the County in 2019 was not taken from the PFM account. This finding supports both the compounding of NCLA interest over time (mentioned above) and the argument that NCLA should not bear the impact of gains/losses characteristic of a fund based on an active-trading model (one that applies longer term algorithms to short term security purchases and sales).

I also observed that PFM's Quarterly reports submitted to City Council are presented on a different basis, and not readily reconcilable, to the accumulated results of monthly statements. We have learned that PFM's quarterly statements are constructed on an accrual/amortized basis while monthly statements focus on actual cash-basis earnings. This further supports the use of the monthly reports for this analysis. Los Altos also used the PFM monthly reports to calculate interest earnings, adding the earnings from three months and posting quarterly.

Exhibit A concludes that **NCLA is due an additional \$58,977 in interest** for the entire 37 month period. The analysis arrives at a total interest recalculation of \$186,340 which equates to an annual earnings rate of 1.88% over the term. **Exhibit B** reveals **the actual interest income recorded by the City** in the format of a trial balance extract. This amount totals \$127,363 translating to an annual earnings rate of 1.32%, notably lower than the recalculated amount.

Cash Balances and Additional Interest due NCLA

The City recently remitted a detailed (unaudited) NCLA trial balance through June 30, 2020 indicating \$327,048.91 held by the City in the LAIF account, and \$450,413.15 held in the City’s general bank account. Once February 28, 2021 reports are received, we can expect these amounts to marginally change for LAIF earnings and vendor payments made.

Including the additional interest due, the total funds to be transferred to NCLA by the City, pending any minor adjustments, follow:

General Cash	450,413.15
LAIF Balance	327,048.91
Interest Due	58,977.00
Total Funds Due NCLA	\$836,439.06

This recalculation of interest has been presented to the City for their review and we await their comments. Tonight we seek the Boards’ approval to finalize discussions with the City and proceed with transferring funds to SCC. This approval is conditioned on the City’s substantial agreement with our analysis, defined as a variance not greater than 10% (greater or lesser) of recalculated interest noted above.

SCC Accounting/Reporting Process

We have been in contact with SCC to confirm they are ready and able to handle the accounting for NCLA investments. Since the initial transfer of PFM dollars to them in October 2019, they have demonstrated the ability to accept County tax deposits and make vendor payments. Further inquiries support the County’s ability to send financial reports to NCLA monthly. This includes a trial balance comprised of balance sheet, revenue and expenditure accounts which NCLA can use to prepare the financial statements in its desired format. Although SCC will not maintain budgetary data, their reports provide actual results and balance sheet data in support of future audits and the budget process. Going forward, NCLA can craft its own internal reports for financial status and budgeting. In addition, SCC has a long standing history of providing pool investment reports available monthly and quarterly to be made available to the Board.

Closing Comments

I would be remiss not to thank both Suzanne Epstein and Marcie Scott for their assistance and informational guidance in this process. Discussions with them were critical in establishing key connection points with agency contacts and data sets. It was a collective team effort.

Final Recommendations

That the NCLA Board:

- (1) accept and receive this analysis of interest due from the City for the the 37 month period extending from October 2016 through October 2019, and
- (2) conditionally direct, as specified in this staff report, the project team to finalize the full transfer of NCLA funds remaining with the City through February 28, 2021, plus the recalculated amount of interest due.

Exhibit A - Monthly Calculation of NCLA Interest Earned in PFM Commingled Account

Month-Year	PFM Full City Mkt Value	PFM Full City Interest	Monthly Yield %	NCLA Balance	NCLA Balance %	NCLA Interest Allocation
Notes	A	B		C	D	E
October-16	44,079,891	47,856	0.11%	3,132,000	7.11%	3,400
November-16	43,881,019	29,095	0.07%	3,135,400	7.15%	2,079
December-16	43,912,097	58,435	0.13%	3,137,479	7.14%	4,175
January-17	44,649,404	31,546	0.07%	3,141,654	7.04%	2,220
February-17	44,696,893	47,633	0.11%	3,143,874	7.03%	3,350
March-17	48,529,273	41,260	0.09%	3,147,224	6.49%	2,676
April-17	48,608,584	70,119	0.14%	3,149,900	6.48%	4,544
May-17	50,674,111	70,386	0.14%	3,154,444	6.22%	4,382
June-17	50,678,017	64,062	0.13%	3,158,826	6.23%	3,993
July-17	53,755,687	59,649	0.11%	3,162,819	5.88%	3,510
August-17	53,875,428	65,509	0.12%	3,166,328	5.88%	3,850
September-17	53,818,642	35,838	0.07%	3,170,178	5.89%	2,111
October-17	53,786,829	87,323	0.16%	3,172,289	5.90%	5,150
November-17	53,681,870	107,150	0.20%	3,177,439	5.92%	6,342
December-17	53,646,918	64,250	0.12%	3,183,782	5.93%	3,813
January-18	53,472,462	70,275	0.13%	3,187,595	5.96%	4,189
February-18	53,446,025	77,734	0.15%	3,191,784	5.97%	4,642
March-18	53,613,288	48,692	0.09%	3,196,426	5.96%	2,903
April-18	53,602,108	103,235	0.19%	3,199,329	5.97%	6,162
May-18	53,794,122	82,800	0.15%	3,205,491	5.96%	4,934
June-18	53,804,829	66,274	0.12%	3,210,425	5.97%	3,954
July-18	53,860,536	86,018	0.16%	3,214,379	5.97%	5,134
August-18	53,849,895	72,383	0.13%	3,219,513	5.98%	4,328
September-18	53,994,722	93,458	0.17%	3,223,840	5.97%	5,580
October-18	54,008,993	98,271	0.18%	3,229,420	5.98%	5,876
November-18	53,306,146	105,679	0.20%	3,235,296	6.07%	6,414
December-18	54,466,380	98,505	0.18%	3,241,710	5.95%	5,863
January-19	54,855,348	124,045	0.23%	3,247,573	5.92%	7,344
February-19	58,933,648	91,071	0.15%	3,254,917	5.52%	5,030
March-19	59,184,391	100,073	0.17%	3,259,947	5.51%	5,512
April-19	59,398,417	134,265	0.23%	3,265,459	5.50%	7,381
May-19	59,362,428	106,205	0.18%	3,272,840	5.51%	5,855
June-19	60,044,137	108,046	0.18%	3,278,696	5.46%	5,900
July-19	56,909,797	205,071	0.36%	3,284,596	5.77%	11,836
August-19	57,478,890	114,607	0.20%	3,296,431	5.74%	6,573
September-19	57,284,714	100,921	0.18%	3,303,004	5.77%	5,819
October-19	58,184,431	167,350	0.29%	3,308,823	5.69%	9,517
Total NCLA interest						186,340
Amount Booked by City						127,363
Under-recorded Interest						58,977
NCLA Annual Earnings %						1.88%

Notes:

- A - Closing Market Value of City commingled holdings per PFM month end statements
- B - interest/Dividends/Coupons received per City commingled PFM month end statements
- C - \$3.12M NCLA contribution increased monthly by allocated interest compounded through Oct 2019 (37 mths)
- D - NCLA's share of the total month end PFM Market Value Balance (C / A)
- E - Interest allocation per this analysis based on a growing principal balance (D x B)

Exhibit B - Accounting of City booked NCLA interest from FY 16-17 to October 2019

Notes							A
4305 - Portfolio Income	Journal	Description	Dr	Cr	Bal		
1/31/2017	JE170122	PFM PORTFOLIO INTEREST 9/16	ST	0	1,665.10	1,665.10	
1/31/2017	JE170123	PFM PORTFOLIO INTEREST 9/17	ST	0	6,432.36	6,432.36	
4/30/2017	JE170412	PFM PORTFOLIO INTEREST 9/18	ST	0	5,773.48	5,773.48	
6/30/2017	JE170638	PFM PORTFOLIO INTEREST 9/19	ST	0	8,171.10	8,171.10	
6/30/2017	JE170634	PFM PORTFOLIO INTEREST 9/20	ST	1,660.75	0	-1,660.75	
6/30/2017	JE170633	PFM PORTFOLIO INTEREST 9/21	ST	558.08	0	-558.08	
6/30/2017	JE170632	PFM PORTFOLIO INTEREST 9/22	ST	111.07	0	-111.07	19,712.14
10/31/2017	JE181015	PFM PORTFOLIO INTEREST 9/23	ST	0	6,139.19	6,139.19	
1/31/2018	JE180115	PFM PORTFOLIO INTEREST 9/24	ST	0	11,128.69	11,128.69	
4/30/2018	JE180424	PFM PORTFOLIO INTEREST 9/25	ST	0	8,692.97	8,692.97	
6/30/2018	JE180634	PFM PORTFOLIO INTEREST 9/26	ST	0	11,904.95	11,904.95	37,865.80
10/31/2018	JE191012	PFM PORTFOLIO INTEREST 9/27	ST	0	12,106.62	12,106.62	
1/15/2019	JE190109	PFM PORTFOLIO INTEREST 9/28	ST	0	13,906.96	13,906.96	
4/15/2019	JE190412	PFM PORTFOLIO INTEREST 9/29	ST	0	12,881.94	12,881.94	
6/30/2019	JE190639	PFM PORTFOLIO INTEREST 9/30	ST	0	15,832.95	15,832.95	54,728.47
10/30/2019	JE200117-01	Transfer invest. to SCC	0	15,056.38	15,056.38	15,056.38	15,056.38

Object 4305 Total **17,386.28 129,692.69 127,362.79 127,362.79**

NCLA Annual Earnings % 1.32%

Notes:
A - This is an extract from the Los Altos general ledger quantifying interest recorded on a quarterly basis